

After years of plane analogies, we're now back to porridge - US rate cut ushers in Goldilocks environment

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Sebastian Mullins, head of multi-asset and fixed income for Schroders: Australia, writes that markets are rejoicing as they price in a new US rate cutting cycle combined with above trend growth. But even if the porridge is just right, Goldilocks would scoff at the price.

September saw all assets rally – equities, government bonds, corporate credit, currencies, commodities and gold all rose over the month. This was thanks to the US Federal Reserve (Fed), who resumed their cutting cycle at the September meeting, cutting rates by 25 basis points to a target range of 4.00 to 4.25%. The weaker than expected non-farm payrolls convinced the Fed that an insurance rate cut was necessary to help avoid an increase in unemployment. However, outside of the job market, the US economic backdrop continued to see improvements.

US economy running hot

US second quarter GDP was revised upwards to 3.8% and personal consumption was revised higher to 2.6%. This increase in household spending occurred despite a higher savings rate, as real wage growth remained strong. Producer prices rose 3.3% over the year, the highest increase since 2022, led by services as opposed to tariff-related goods. Composite Purchasing Manager Indices (PMIs) continued to improve, financial conditions continued to ease, and corporate earnings revisions are turning more positive.

Chart 1: Second quarter GDP was revised up again



Source: Macrobond, Schroders Economics Group. 28 September 2025

While the weak job numbers are a concern, they come as immigration policies lower the breakeven jobs rate from 100-200k to around 50k, keeping the unemployment rate broadly anchored.

It is too early to know if the recent weakness is related to short term tariff uncertainty, or the start of something more ominous.

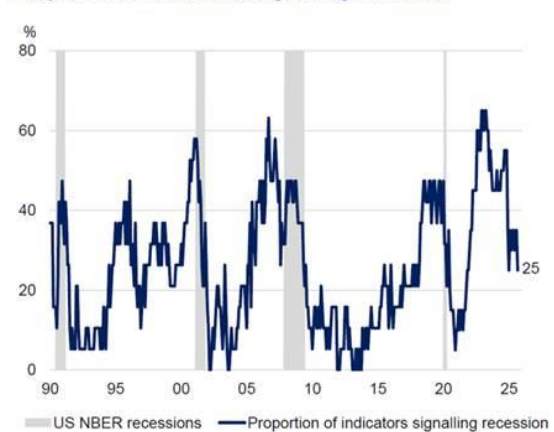
The recent lower-than-expected initial jobless claims and rate cut by the Federal Reserve keeps us from viewing this as a recessionary indicator, for now. Meanwhile, our US recession dashboard has seen less indicators flagging, reducing the risk of a recession. We will continue to watch the labour market for signs of cracks, but for now, we believe the Fed is cutting rates in a non-recessionary environment.

Chart 2: US recession risk has fallen, with no near-term indicators flagging

US Recession Dashboard

Indicator	Latest value	Sign	Critical threshold	Signalling recession yes (Y) or no (N)	Typical lead time in signalling recession (months)
Inflationary					
Truck sales	0.4	>	0.4	N	24
Output gap	1.3	>	1.0	Y	24
Initial jobless claims	218.0	<	321.0	Y	23
Capacity utilisation	77.4	>	81.6	N	21
Unemployment gap	0.0	<	-0.4	N	17
Commodity prices, y/y%	5.0	>	11.1	N	15
Monetary					
Yield curve (10 year minus three-month Treasury bill)	0.4	<	0.3	Y	13
Fed funds rate, change over the last two years	-1.2	>	1.5	N	12
Fed fund rate relative to cycle low	4.0	>	3.6	Y	12
Real money base, y/y%	-2.5	<	-0.7	Y	9
Real narrow money supply, y/y%	1.8	<	-2.0	N	6
Real broad money supply, y/y%	2.1	<	1.9	N	5
Real-time business and financial markets					
ISM new orders, six-month change, %	5.8	<	-5.7	N	5
Private house permits, y/y%	-11.5	<	-19.5	N	3
S&P 500, six-month return, %	19.2	<	-6.0	N	2
ISM new orders	51.4	>	48.8	N	1
VIX index	15.7	>	23.4	N	1
Average weekly hours (manufacturing sector), y/y%	0.5	<	-1.0	N	1
Chicago Fed activity index	-0.2	<	-0.4	N	1
Consumer good orders, y/y%	-0.3	<	-1.0	N	1
Proportion of indicators signalling recession	25%				

Proportion of indicators signalling recession



Source: Schroders, 30 September 2025.

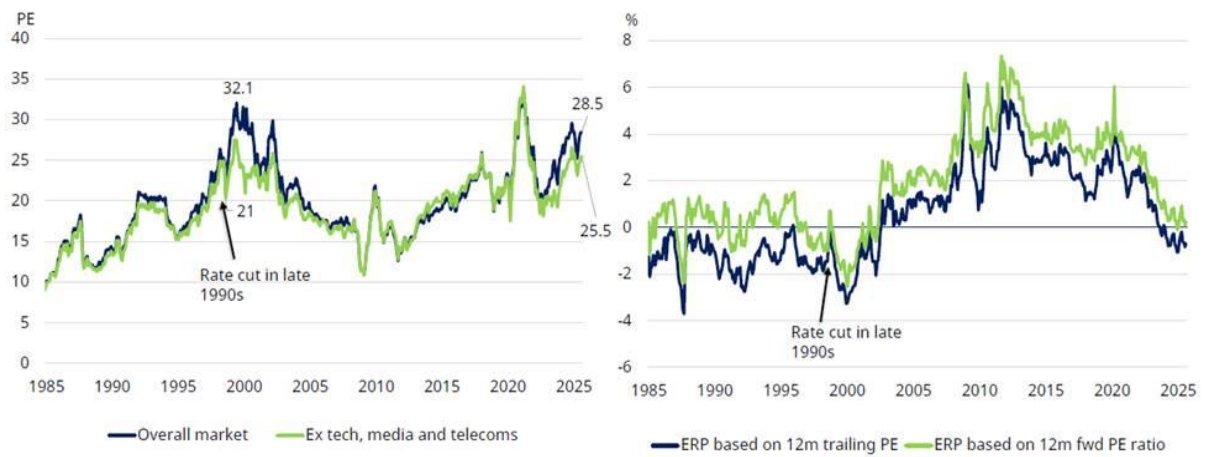
This unfortunately means that after years of talking about different kinds of plane landing analogies, financial commentators will once again be talking about porridge (which is not to be confused with OATs – French government bonds – an entirely different conversation). With the Fed cutting rates and the economy holding up, we will enter a goldilocks environment, which is good for all assets, or at least that is what the market is pricing in.

Everything is expensive

With US inflation remaining somewhat benign (although see Lying in wait for our view on delayed inflation), the weak labour market has allowed markets to pencil in two more rate cuts this year and another two next year, with a terminal rate of just below 3% by end 2026. This is unlikely to eventuate, outside of a recession.

In our view, bonds are now expensive. Risk assets are also celebrating as these rate cuts are coupled with strong economic growth. This has seen corporate credit spreads tighten close to their lowest levels in at least 20 years and equity multiples get unnervingly close to those seen in the late 1990s. It seems everything is priced to perfection.

Chart 3: US equity valuations are elevated led by tech, echoing but not as bad as the 1990s



Source: LSEG. 26 September 2025

We believe too many rate cuts are priced and equity valuations will re-rate lower as these cuts get priced out as the economy recovers and tariff-induced inflation starts to percolate.